TEOH PENG PHE

v.

WAN & CO

HIGH COURT MALAYA, KUALA LUMPUR
KANG HWEE GEE J
[SUIT NO: D5-24-339-1999]
13 NOVEMBER 2000

CIVIL PROCEDURE: *Discovery - Discovery against company's appointed auditors for information leading to directors' wrongdoing - Whether discovery available as auditors not privy to relationship between involved parties - Whether in light of irregularities found auditors owe a moral duty to shareholders to disclose information - Norwich Pharmacal Co v. Customs and Excise Commissioners*

COMPANY LAW: *Members' rights - Right to bring action for directors' wrongdoing - Whether with minority shareholder - Rule in Foss v. Harbottle - Whether exception thereto applicable*

The plaintiff was a minority shareholder of a company called Master Concept Sdn Bhd ('the company'). The defendant was a firm of auditors appointed by the company. The plaintiff claimed that at the company's Extraordinary General Meeting ('EGM'), a resolution was sought for members to ratify loans and advances made to certain debtors of the company which the directors of the company had interests in and that was not disclosed to the shareholders. Further, the plaintiff had detected certain discrepancies in three sets of draft statement of accounts prepared by the defendant for the year ended 31 August 1998 which led the plaintiff to believe that the directors of the company had mismanaged the funds of the company.

As the plaintiff was unable to obtain full information pertaining to the identities of the wrongdoers, the plaintiff made this application for discovery of certain documents in the possession of the defendant.

Held:

[1] Although the discovery and inspection of documents is only applicable between involved parties, a separate action for discovery is available against a stranger under the principle in *Norwich Pharmacal Co v. Customs and Excise Commissioners* where (i) without discovery no action could be begun against the wrongdoer, and (ii) the person against

whom discovery was sought had himself, through no fault of his own, facilitated the wrongdoing and as such was under a duty to assist the person who had been wronged by giving him full information and disclosing the identity of the wrongdoer.

[2] The discrepancies in the three sets of draft statement of accounts would not by themselves justify the plaintiff's allegation that the directors of the company had mismanaged its fund. They were merely drafts submitted for the perusal for the members before the EGM and being drafts they were liable to amendments. Accordingly, there was no reason to find that the directors had committed a tortious act against the company on that ground alone.

[3] There was clearly some substance with respect to the complaint that the directors of the company were also directors of the other debtors to whom loans had been made. That justified the finding that a tortious act might have been committed by them for a director owes a fiduciary duty to act honestly in the interest of the company under s. 132(1) of the Companies Act 1965.

[4] The loans to directors or to persons connected with them could not be ratified merely by a resolution passed by a simple majority at a general meeting, the effect of which would have left the minority who voted against the said resolution dissatisfied.

[5] Under the Penal Code directors are agents of the company with respect to the funds of the company entrusted to them. They are liable to be charged under s. 409 of the said Code if they make loans to themselves or to persons connected with them in breach of their fiduciary duty. Further, a person who procures the misapplication of the company's fund for his own benefit may be guilty of abetment of criminal breach of trust.

[6] Although an examination of the list of debtors of the company might not have revealed that unauthorised loans had been made, such irregularities could have been detected with due diligence by the auditors, given that the company had convened an EGM to ratify the said loans. Having failed to disclose the irregularities, the auditors now owe a moral duty to disclose the identities of the wrongdoer directors to the plaintiff.

[7] The court agreed with the defendant's submission that an order of discovery is unavailable where the identity of the wrongdoers is already known. In this case, although the identities of the directors acting

collectively in approving the loans were already known, they might not necessarily be the wrongdoers who were the receivers of the loans, *ie*, persons from whom the plaintiff intended to sue to recover the loans on behalf of the company.

[8] On the defendant's submission that the right of action lay with the company and not with the plaintiff as the alleged wrong was done to the company, the exception to the rule in *Foss v. Harbottle* applied if fraud on the minority had been committed. A minority member may be allowed not as a matter of right but merely by the grace of the court to bring an action to enforce the company's right by a derivative action in the name of the company.

[9] A prospective plaintiff applying for the relief under the *Norwich Pharmacal* principle need only to demonstrate that he has a viable cause of action against the wrongdoer and that the discovery is required in order that he may know for certain whether he has such a cause of action. The court need not determine at this stage whether he will succeed in his action against the wrongdoers.

[10] The plaintiff was amply justified to apply for a *Norwich Pharmacal* discovery against the defendant. The plaintiff should give an undertaking to the defendant to restrict the use of the documents only for the specific purpose of initiating a derivative action against the wrongdoers to recover such monies due to the company.

[Order accordingly.]

Case(s) referred to:

Abdul Rahim Aki v. Krubong Industrial Park (Melaka) Sdn Bhd & Ors [1995] 4 CLJ 551 ***(refd)***

Bamford v. Bamford Ch 212 ***(refd)***

Bankers Trust Co v. Shapira [1980] 3 All ER 353 ***(refd)***

Burland v. Earle [1902] AC 83 ***(refd)***

Chang Lee Swee v. PP [1985] 1 MLJ 75 ***(refd)***

CHC Software Ltd v. Hopkins and Wood [1993] Fleet Street Report 24 ***(refd)***

Co-operative Central Bank Ltd (In receivership) v. Feyen Development Sdn Bhd [1995] 4 CLJ 300 ***(refd)***

Cook v. Deeks [1916] 1 AC 554 ***(refd)***

Distillers Co (Biochemicals) Ltd v. Times Newspaper Ltd [1975] QB 613 ***(refd)***

First Malaysia Finance Bhd v. Dato' Mohd Fathi Hj Ahmad [1993] 3 CLJ 329 ***(refd)***

Foss v. Harbottle 1843 Hare 461 ***(refd)***

Handmade v. Express Newspapers [1986] FSR 463 ***(refd)***

Ikumene Singapore Pte Ltd v. Leong Chee Leng [1993] 3 SLR 24 ***(refd)***

Interfood Sdn Bhd v. Arthur Andersen & Co & Anor [2000] 1 CLJ 511 ***(refd)***
Lee Lim Huat v. Yusof Khan Ghows Khan & Anor [1997] 3 CLJ 197 ***(refd)***
Mortom-Norwich Products Inc v. Intercon No 2 [1981] FSR 337 ***(refd)***
Norwich Pharmacal Co v. Customs and Excise Commissioners [1973] 2 All ER 943 ***(refd)***
P v. T [1997] 4 All ER 200 ***(refd)***
PP v. Tan Koon Swan [1987] 1 MLJ 18 ***(refd)***
Samuel Tak Lee v. Chou Wen Hsien [1984] 1 WLR 1202 ***(refd)***
Tan Hian Tsin v. PP [1979] 1 MLJ 73 ***(refd)***
Tan Guan Eng v. Ng Kweng Hee [1992] 1 MLJ 487 ***(refd)***
Tay Choo Wah v. PP [1976] 2 MLJ 95 ***(refd)***
Woodland Development Sdn Bhd v. Chartered Bank [1986] 1 MLJ 84 ***(refd)***

Legislation referred to:
Companies Act 1965, ss. 132(1), 133A, 172
Penal Code, s. 409
Rules of the High Court 1980, O. 18 r. 19, O. 24

Other source(s) referred to:
Company Law, Walter Woon, 2nd edn, pp 382 & 383
Ford's Principle of Corporations Laws, 6th edn, para 1525
Litigation: Evidence and Procedure, Aronson, Reaburn, Weinberg, 3rd edn
Norwich Pharmacal, All England Reports, p 943
Overcoming Regulatory Authority's Resistance to Disclose Information, Dr Aiman Nariman, [2000] 4 MLJ Ixxiii
The Supreme Court Practice [1995] Vol 1 432

For the plaintiff - Gideon Tan; M/s Gideon Tan Razali Zaini
For the defendant - Sivasankar; M/s Cheah Teh & Su

Reported by Usha Thiagarajah

JUDGMENT

Kang Hwee Gee J:

The plaintiff is a minority shareholder of a company called Master Concept Sdn. Bhd.

By this Originating Summons he seeks to compel the defendant firm, the appointed auditors of master concept, to supply him with copies of working papers, all files to the audit accounts and all documentation pertaining to the audited accounts of master concept from 1990 to 1998.

In his affidavit in support of this application he states two grounds why he has to make this application:

1. At the EGM of the company held on 27 August 1999, an item on the agenda sought a resolution that members ratify loans and advances made to certain debtors of the company. These debtors he alleged were wholly or substantially companies in which the directors themselves had interests.

The relevant paragraphs of his affidavit alluding to this reads as follows:

(a) Chong Ah Goh and Teoh Ah Too @ Chong Chiew Sun are directors of Master Concept Sdn Bhd. However they are also the directors for Watta Manufacturing Sdn Bhd, a dormant company who owes Master Concept Sdn Bhd the amount of RM31,342.44 (Ringgit Malaysia Thirty One Thousand Three Hundred Forty Two and cents Forty Four). The two similar names also appeared as directors of two other dormant companies, Loyal Ace Sdn Bhd who owes Master Concept Sdn Bhd the amount of RM78,837.50 (Ringgit Malaysia Seventy Eight Thousand Eight Hundred Thirty Seven and cents Fifty) and Teoh Capital Holding Sdn Bhd owing the sum of RM6,187.60 (Ringgit Malaysia Six Thousand One Hundred Eighty Seven and cents Sixty);

(b) Furthermore, the names of Chong Ah Goh and Teoh Ah Too @ Chong Chiew Sun appeared as directors of Jutali Sdn Bhd. This company is in the lists of other debtors for Master Concept Sdn Bhd and owes the sum of RM92,400 (Ringgit Malaysia Ninety Two Thousand Four Hundred);

(c) Then together with Teoh Ah Lak and Teoh Choon Sing, who are also directors of Master Concept Sdn Bhd, the names of Chong Ah Goh and Teoh Ah Too @ Chong Chiew Sun once again appeared as directors for another dormant company, Preconceptor Sdn Bhd who owes Master Concept Sdn Bhd the sum of RM48,121,15 (Ringgit Malaysia Forty Eight Thousand One Hundred Twenty One and cents Fifteen);

(d) The names of Teoh Ah Lak, Chong Ah Goh and Teoh Ah Too @ Chong Chiew Sun again appeared as directors for a dormant company, Marvel Resource Sdn Bhd owing Master Concept Sdn Bhd the sum of RM11,935 (Ringgit Malaysia Eleven Thousand Nine Hundred Thirty Five);

(e) A company by the name of Profound Legacy Sdn Bhd owes Master Concept Sdn Bhd the amount of RM3,250 (Ringgit Malaysia Three Thousand Two Hundred Fifty) and the directors of this company includes Chong Ah Goh and Teoh Ah Too @ Chong Chiew Sun;

(f) Chong Ah Goh, one of the directors of Master Concept Sdn Bhd is also the director of Bukit Tinggi Tradelines Sdn Bhd who owes Master Concept Sdn Bhd the sum of RM3,500 (Ringgit Malaysia Three Thousand Five Hundred); and

(g) Further, Chong Ah Goh and Teoh Choon Sing are also the directors of Spanapex Sdn Bhd who owes Master Concept Sdn Bhd the amount of RM2,873.60 (Ringgit Malaysia Two Thousand Eight Hundred Seventy Three and cents Sixty).

8. Watta Energy (M) Sdn Bhd owes Master Concept Sdn Bhd the amount of RM70,000 (Ringgit Malaysia Seventy Thousand) for the period ended 31/08/98. In accordance to the company searches exhibited hereto as TPP-2, the names of Teoh Ah Too @ Chong Chew Sun, Chong Ah Goh and Teoh Choon Sing appeared as company directors for Watta Energy (M) Sdn Bhd at the date of the annual return reported on 27th March 1998. It is to be noted that Teoh Ah Too @ Chong Chiew Sun have resigned with effect from 23/09/98 whilst Chong Ah Goh later resigned with effect from 18/11/98 and Teoh Choon Sing resigned with effect from 31/10/98. With reference to exhibit TPP-2, the schedule of Other Debtors is for period ended 31/08/98. I would respectfully say that Teoh Ah Too @ Chong Chiew Sun, Chong Ah Goh and Teoh Choon Sing were still holding office as directors of Watta Energy (M) Sdn Bhd when Master Concept Sdn Bhd allowed the loans and advances to Watta Energy (M) Sdn Bhd.

He concludes therefore the directors of the company had taken advantage of their position and had utilised funds of the company for their own private purpose in breach of their fiduciary duty which they owe to members of the company.

This notwithstanding, the auditor had not deemed it fit to warn shareholders in their reports that the majority of the 'other debtors' companies were also the directors of Master Concept and the loans had been made to them.

2. The auditors had prepared three sets of draft statement of accounts for the year ended 31 August 1998 dated 16 March 1999, 31 March 1999 and 18 May 1999 respectively, wherein the plaintiff has detected certain material discrepancies as follows:

12 (b) In the draft accounts dated 16/03/99, the figure for the amount owing to the directors is RM192,866.00 (Ringgit Malaysia One Hundred Ninety Two Thousand Eight Hundred Sixty Six) but however the amount was raised to RM2,115,170.00 (Ringgit Malaysia Two Million One Hundred Fifteen Thousand One Hundred Seventy) in the two later draft accounts;

(c) The figures for the repayment to directors is RM192,866.00 (Ringgit Malaysia One Hundred Ninety Two Thousand Eight Hundred Sixty Six) for the first two draft accounts, but the amount was reduced to RM120,791.00 (Ringgit Malaysia One Hundred Twenty Two Thousand Seven Hundred Ninety One) in the draft accounts dated 18/05/99;

(d) It was reported in the first two draft accounts that there is accumulated losses of RM25,651.00 (Ringgit Malaysia Twenty Five Thousand Six Hundred Fifty One) resulting in a capital deficiency of RM15,651.00 (Ringgit Malaysia Fifteen Thousand Six Hundred Fifty One). However in the last draft accounts the reported accumulated losses is reduced to RM10,509.00 (Ringgit Malaysia Ten Thousand Five Hundred and Nine) resulting in a capital deficiency of RM509.00 (Ringgit Malaysia Five Hundred and Nine); and

(e) There are differences in the amount owing for Other Creditors, accruals and deposits as the amount was RM1,867,916.00 (Ringgit Malaysia One Million Eight Hundred Sixty Seven Thousand Nine Hundred Sixteen) in the first draft accounts dated 16/03/99 but the figure later decreased to RM1,735,755.00 (Ringgit Malaysia One Million Seven Hundred Thirty Five Thousand Seven Hundred Fifty Five).

By reason of these discrepancies the plaintiff believes that the directors of Master Concept Sdn. Bhd. had mismanaged the funds of the company.

He was unable to obtain the full information pertaining to the disclosure of the true identities of the wrongdoers who were in breach of their fiduciary duty arising from the misuse of such funds of the company except from the defendant auditor, who would have in its posession copies of the records of the accounts of the company for the years ending 1995 to 1998.

He had through his solicitors written a letter dated 9 September 1999 to the defendant auditors seeking explanations for the discrepancies in the accounts but they had refused to supply any information.

He believes that the defendant as the auditors of the company had facilitated the wrongdoings of the directors by reason of:

(a) their failure to inspect the linked relations between the other debtors and directors of Master Concept Sdn Bhd; or

(b) their failure to disclose the directors' interest in the other debtors companies in their auditors report; or

(c) failure to report on the directors' breach of their fiduciary duties in approving loans and advances to the other debtors.

The Law

Under O. 24 of the Rules of the High Court 1980, only parties are obliged to give discovery of documents and only parties can request for the process. A party is said to "discover" a document when he reveals its existence to his opponent. The practice prevailing here as in other common law jurisdictions is for the party acceding to discovery to make a written list of documents which he now has in his possession, custody or power and which he is prepared to show to his opponent; a second list of documents which he uses but no longer has in his custody, possession or power, detailing what has become of them; and a third list of documents which he has in his possession but which he declines to show to his opponent on account of privilege. (See *Aronson, Reaburn, Weinberg, Litigation: Evidence and Procedure* 3rd edn).

But O. 24 of the Rules is concerned only with the discovery and inspection of documents between involved parties. It cannot be applied against a stranger even though he may have been privy to the relationship between the involved parties. This is so because there is no cause of action against the stranger to subject him to the due process of law. A party wishing to avail himself of the benefit of a document in the hands of a stranger would therefore have to apply for a subpoena *duces tecum* to compel him to produce the document required in court.

A separate action for discovery outside of O. 24 is however available against a stranger under the principle in *Norwich Pharmacal Co v. Customs and Excise Commissioners* [1973] 2 All ER 943 which the former Supreme Court had adopted and applied in *First Malaysia Finance Bhd v. Dato' Mohd Fathi bin Haji Ahmad* [1993] 3 CLJ 329 – to the extent that a party contemplating to sue another may now under certain circumstances be able to bring a separate action against a stranger to compel him to produce such documents that he may require to facilitate his action (see *Interfood Sdn Bhd v. Arthur Andersen & Co & Anor* [2000] 1 CLJ 511, *Lee Lim Huat v. Yusof Khan Ghows Khan & Anor* [1997] 3 CLJ 197. See also *Dr Aiman Nariman: Overcoming regulatory authority's resistance to disclose information* [2000] 4 MLJ Ixxiii).

The principle in *Norwich Pharmacal* was accurately summarised by the editor of the All England Reports at p. 943 as follows:

> Although as a general rule no independent action for discovery would lie against a person against whom no reasonable cause of action could be alleged, or who was in the position of a mere witness in the strict sense, the rule did not apply where,

(a) without discovery of the information in the possession of the person against whom discovery was sought no action could be begun against the wrongdoer, and

(b) the person against whom discovery was sought had himself, *albeit* through no faults of his own, been involved in the wrongful acts of another so as to facilitate the wrongdoing. In such circumstances, although he might have incurred no personal liability, he was under a duty to assist the person who had been wronged by giving him full information and disclosing the identity of the wrongdoer.

In *First Malaysia Finance, supra,* the plaintiff contracted to sell his shares in *First Malaysia Finance* to the 1st, 2nd, 3rd and 4th defendants with the option for them to pay the purchase price of the shares to the accounts of several companies controlled by the plaintiff which had obtained loans from the 5th defendant in a manner that contravene s. 133A of the Companies Act 1965 which prohibits the granting of loans to persons connected with directors.

The plaintiff brought an action to recover the purchase price of the shares from the 1st, 2nd, 3rd and 4th defendants. The 1st, 2nd, 3rd and 4th defendants claimed that they had paid the purchase price into the loan accounts of these companies at *First Malaysia Finance.*

The plaintiff brought an action against *First Malaysia Finance* for the discovery of the relevant accounts to show if any such payments had been made.

First Malaysia Finance then applied under O. 18 r. 19 to have the plaintiff's claim struck off on ground that it did not disclose any reasonable cause of action, and that it was frivolous, vexatious and an abuse of the process of the court. The High Court held the view that the plaintiff's claim for discovery against *First Malaysia* had come within the ambit of the exception in *Norwich Pharmacal Co.* It sustained the plaintiff's action and dismissed *First Malaysia Finance's* application.

The decision was reversed on appeal to the Supreme Court. The Supreme Court accepted the principle in *Norwich Pharmacal,* but distinguished it on the facts. It held that the principle cannot be applied in that case as the identity of those who were alleged to have committed the wrongful act against the plaintiff was already known to the plaintiff. They had in fact been cited as the 1st to 4th defendants in the same suit. It was held further that the principle in *Norwich Pharmacal* relates only to tortious acts and as the plaintiff's claim against the 1st to 4th defendants was grounded in contract, *Norwich Pharmacal* could not be applied. The relevant passage of the judgment for our purpose is to be found at pp. 506 and 507 (per Edgar Joseph Jr SCJ):

In our view, there can be no doubt that *Norwich Pharmacal* is in effect a consolidation of the early authorities on discovery, which the House had approved. We also note that the scope of *Norwich Pharmacal* is limited by the 'mere witness' and 'mere tort' rules. We would respectfully follow the principles enunciated by the House of Lords in *Norwich Pharmacal* case and it was with those principles in mind that we turn to consider the particular circumstances of the present case in order to decide whether the judge was right in making the order he did in fact make.

Unlike the *Norwich Pharmacal* case, the present case was one where the identity of those who were alleged by the plaintiff to have committed the wrongful acts *vis-a-vis* the plaintiff were known to the plaintiff and, indeed they had been cited as the first to fourth defendants in the action. Again, the cause of action pleaded against the first to fourth defendant was grounded in contract so there was no question of the plaintiff being able to invoke the exception defined by the house of Lords in the *Norwich Pharmacal* case, namely, that if through no fault of his own, a person gets involved in the tortious acts of others so as to facilitate their wrongdoing, whilst he may incur no personal liability, he comes under a duty to assist the person who has been wronged by giving him full information and disclosing the identity of the wrongdoers. So, on this ground alone, there was no question of the fifth defendant, being such a 'person' within the meaning of the exception.

To take the point a little further, the obligation incurred by the first to fourth defendants to make payments of the purchase price to the borrowers' account being purely contractual, no third party could be said to be mixed up in a contractual situation because of the doctrine of privity.

The Basis For Making This Application

Mr. Gideon Tan counsel for the plaintiff says that the auditors in this Summons come within the bounds of the principle in *Norwich Pharmacal* as adopted in *First Malaysia Finance, supra*.

The defendant auditors he submits was under a moral duty to "provide full information and the identity of the wrongdoer" as he "is the person who through no fault of his own gets mixed up in the tortious act" of the company by the act of its directors.

The defendant did not deny that the loans as alleged were made to the directors or persons connected with them. But it opposed the right of the plaintiff to make this application on the following grounds:

1. The *Norwich Pharmacal* procedure would not apply as the plaintiff has failed to show that the directors of the company had committed a tortious

act and that the defendant had facilitated or had been mixed up with the alleged tortious act of the directors.

2. The order being discretionary should not be granted as the plaintiff had failed to avail himself of the opportunity to seek an explanation and clarification from the board of directors as directed and agreed upon by the defendant at the AGM on 23 December 1999.

3. The plaintiff was out-voted at the AGM on 23 December 1999 wherein a resolution to adopt and receive the company's accounts for the year ending 31 August 1996, 31 August 1997 and 31 August 1998 was passed by the majority of the shareholders.

4. There were no irregularities in the accounts of the company and the defendants had made it clear that they were merely drafts which were subjected to adjustments and corrections. The actual audited accounts of the company had been approved at the AGM of the company on 23 December 1999.

5. The right of action lies with the company and not with the plaintiff as the wrong was done to the company and only the company has the right to bring an action.

6. An auditor owes a duty to the general body of shareholders and not to individual shareholders.

7. The defendant does not have the accounts and other accounting records of Master Concept Sdn Bhd. as under the Companies Act 1965 they have to be kept by the company and all the documents on which the audit was based on are now in the custody of the company.

Have The Directors Committed Any Tortious Act?

The discrepancies in the three draft statement of accounts constituting the second ground *(supra)* would not by themselves justify the plaintiffs allegation that the company by its directors had mismanaged its fund. I accept the submission of counsel for the defendant that they were merely drafts submitted for the perusal of the members before the AGM and being drafts were liable to amendments. Accordingly, I must conclude that there is no reason to find that the directors have committed a tortious act against the company on this ground alone.

However, with respect to the complaint that the directors of Master Concept were also directors of the 'other debtors' to whom loans had been made, there

is clearly some substance to justify the finding that a tortious act may have been committed by them – for obvious reasons:

A director owes a fiduciary duty to act honestly in the interest of the company. This principle is inscribed in s. 132(1) of the Act which states that:

> A director shall at all times act honestly and use reasonable diligence in the discharge of his office.

Directors are obliged to exercise their fiduciary power in the interest of the company (*Samuel Tak Lee v. Chou Wen Hsien* [1984] 1 WLR 1202 at 1206, *Woodland Development Sdn Bhd v. Chartered Bank* [1986] 1 MLJ 84 at pp. 88, 89).

Their fiduciary duty with respect to the making of loans is aptly described by the Federal Court in *Co-operative Central Bank Ltd (In receivership) v. Feyen Development Sdn Bhd* [1995] 4 CLJ 300, wherein the commentary in *Ford's Principle of Corporations Laws* (6th edn,) at para 1525 was adopted:

> Touching on the background and effect of the Australian equivalent of the Malaysian s. 133, being the Australian Companies Act 1981 s. 234, Prof HAJ Ford in his book, Ford's Principles of Corporations Laws (6th Ed), has this to say (at para 1525, pp. 517-518):
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> > Companies legislation in s. 232(2) [Malaysian s. 132(1)] states the duty of good faith in very broad terms as a duty to act 'honestly'. One aspect of that duty is to refrain from applying the company's resources otherwise than for the benefit of the company as a whole. In companies legislation there are scattered measures on aspects of that duty. The various measures deal only with limited contexts (for example, s. 232(5,) dealing with improper use of company information) in which the duty exists. For such contexts the specific provisions emphasize the basic duty. That legislative emphasis is found in connection with a loan by a company to its director because such a transaction can readily waste a company's resources. Section 234 regulates such loans but in addition to and not in derogation of other law. Presumably, that means that even if a loan is permitted by the legislation, the directors who sanction that loan must consider whether the transaction is for the benefit of the company and not prejudicial to the interests of its creditors. The legislation stems from a recommendation of the Cohen Committee in the United Kingdom who said that it was undesirable that a director should borrow from the company: if the director could offer good security, it would be no hardship to borrow elsewhere; if good security could not be offered, the director should not borrow from the company. In enacting a strict rule about loans to directors the legislature treats

directors like trustees and forbids this form of self-dealing without any provision for the director to be absolved by showing that the particular loan was not prejudicial to the company.

Section 234 forbids, subject to exceptions, a company making a loan to a director or certain other persons, bodies corporate or trusts related to a director. It also forbids the giving of a guarantee or the provision of security in connection with another lender's loan to a director or related person or entity.

The abhorrence of the law against making loans to directors is reflected in s. 133 of the Companies Act 1965 which prohibits a non exempt company from making a loan to its director or his related companies or giving a guarantee or security in connection with such a loan except in the instances mentioned therein. The prohibition is extended under s. 133A to persons connected with the directors. Subsection (4) of both the sections made it an offence punishable by a fine of RM10,000 to contravene either of the section.

As Master Concept appears to be an exempt private company the directors in the instant case may not therefore have committed any criminal offence. Nevertheless they may still be guilty of a breach of their fiduciary duty to the company. A director who commits a breach of his duty under s. 132(1) *supra*, is liable to the company for any profit made by him or for any damage suffered by the company.

Having found that the director could under the circumstances commit a tortious act, the next question to ask is whether the acts of the directors in making the loans may be ratified.

It is common ground that at the EGM held on 27 August 1999 the making of the loans had been ratified by a majority of the members. Would that still make the acts of the directors tortious?

Generally members of a company may ratify and adopt an irregular act of errant directors. Ratification may be effective only in those instances where the directors had acted within their powers but nevertheless in doing so had breached their fiduciary duty. Thus in *Bamford v. Bamford* Ch 212, it was held by the English Court of Appeal that the issuance of shares by the directors acting within their power in the articles although for an improper purpose, could be ratified by an ordinary resolution in a general meeting. But where the directors had not acted within their powers it seems clear that no such ratification can be effective. Thus in *Cook v. Deeks* [1916] 1 AC 554, a purported ratification of the directors' acts in diverting to themselves a contract

which they should have obtained for the company was held to be invalid. The rationale for this decision is provided by Lord Buckmaster in the following passage of the judgment:

> If as their Lordships find on the facts, the contract in question was entered into under such circumstances that the directors could not retain the benefit of it for themselves, then it belonged in equity to the company and ought to have been dealt with as an asset of the company. Even supposing it be not *ultra vires* of a company to make a present to its directors, it appears quite certain that directors holding a majority of votes would not be allowed to make a present to themselves. This would be to allow the majority to oppress the minority.

In the instant case it is plain that in making the loans in the manner alleged by the plaintiff, the directors had in fact transgressed into that aspect of corporate law which prohibits loans to directors or to persons connected with them. The transgression in my view, cannot be ratified merely by a resolution passed by a simple majority at a general meeting, the effect of which would have left the minority who voted against dissatisfied.

There is another reason why the acts of the directors in the instant case (if proved) cannot be ratified. Under the Penal Code directors are agent of the company with respect to the funds of the company entrusted to them. (*Tay Choo Wah v. PP* [1976] 2 MLJ 95 at 98 per Chua J of the Singapore High Court). They are liable to be charged with the offence of criminal breach of trust by an agent under s. 409 of the Penal Code if they make loans to themselves or to persons connected with them in breach of their fiduciary duty. On conviction they are liable to be sentenced to both fine and imprisonment which may extend to 20 years. (See the case of *Tan Hian Tsin v. PP* [1979] 1 MLJ 73 Federal Court, *Chang Lee Swee v. PP* [1985] 1 MLJ 75 High Court).

Further, a person who procures the misapplication of the company's fund for his own benefit (such as the directors in the present case) may be guilty of abetment of criminal breach of trust (*PP v. Tan Koon Swan* [1987] 1 MLJ 18).

Are The auditors Under A Moral Duty To Provide The Information And The Identity Of The Wrongdoers?

The auditor is a compulsory fixture of the company. Under s. 172 of the Companies Act 1965 he must be appointed within three months of incorporation by the directors and thereafter has to be appointed at every AGM.

He is the watchdog of the company and to quote Walter Woon the author of *Company Law* 2nd edn: "If he smells a rat, he must bark."

With respect to the function and duties of the auditor this is what the learned author said at pp. 382 and 383 of his work:

> An auditor's function is to certify the correctness of the company's accounts, to detect errors and to detect fraud, the detection of fraud being generally regarded as being of primary importance. His vital task is to take care to see that errors are not made, be they errors of computation, or errors of omission or commission, or downright untruths.
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> This function is discharged by making a report to the members of the company in accordance with s. 207 and, in the appropriate case, by reporting to the board of the company or the Registrar any irregularities that he has discovered. Section 207(1) requires an auditor to report to the members on the accounts laid before the general meeting and on the company's accounting and other records. In his report, the auditor must state whether in his view the accounts are properly drawn up so as to give a true and fair view of the company's affairs and profit and loss and whether the accounting and other records of the company (and its subsidiaries where appropriate) have been properly kept in accordance with the Act. If the auditor is not satisfied that the accounts or records and registers are in order, he must state this in his report, together with his reasons.
>
> The auditor must also form an opinion as to whether he has obtained all the information and explanations that he required, whether the accounting and other records and the registers of the company have been properly kept in accordance with the Act, whether the returns received from branch officers are adequate, whether the procedures and methods used by a holding company or subsidiary in arriving at the amounts taken into any consolidated accounts were appropriate to the circumstances of the consolidation and whether he agrees with the reasons for preparing consolidated accounts otherwise than as one set for the group. If there is any deficiency, failure or shortcoming in respect of any of these matters, the auditor is bound to state so in his report. The auditor's report must be furnished to the directors in time for them to lay it before the annual general meeting, but no offence is committed by the auditor if the directors have not submitted the accounts in sufficient time for the auditor to make his report.

Having stated the law with respect to the function and duty of the auditor one must now turn to examine whether the defendant auditor had discharged their duty required of them. It is clear that it was his duty as the watchdog of the company to report on any abnormality in the mobilization of the funds of the company by the directors – first and foremost whether they were mobilized in the interest of the company or otherwise.

Having examined all the three draft auditors' report to members of Master Concept Sdn. Bhd. it is clear that none of them had made any mention of the fact that the sums owed by other debtors of the company had included loans made directly or indirectly to directors. Their reports did not say that they had detected any abnormalities in the accounts of the company. On the contrary, they appeared to have vouched that the accounts of the company presented "a fair and true view of the group and of the company." As illustration it is only necessary to reproduce here the last of the three reports dated 18 May 1999 (Ex. TTP-3 of the plaintiffs affidavit) wherein they expressed their satisfaction with the accounts of the company in the following manner:

> We have audited the accounts and notes set out on pages 7 to 20 of Master Concept Sdn Bhd. These accounts are the responsibility of the Company's Directors. Our responsibility is to express an opinion on these accounts based on our audit.
>
> We conducted our audit in accordance with approved Standards on Auditing in Malaysia. These standards require that we plan and perform the audit to obtain reasonable assurance about whether the accounts are free of material misstatement. An audit includes examining, on a test basis, evidence supporting the amounts and disclosures in the accounts. An audit also includes assessing the accounting principles used and significant estimates made by the directors, as well as evaluating the overall accounts presentation. We believe that our audit provides a reasonable basis for our opinion.
>
> As at 31 August 1998, the Group's current liabilities exceeded the current assets by RM3,083,675 (company – RM715,176).
>
> The accounts have been prepared on a going concern basis assuming the continuing financial support from the directors and the shareholders. Should the going concern basis on which the accounts have been prepared be not appropriate, adjustments would have to be made to reduce the value of assets to their realisable amounts and to provide for further liabilities which may arise.
>
> Subject to the above, in our opinion:
>
> (a) the accounts give a true and fair view of the state of affairs of the group and of the company as at 31 August 1998 and of their results and cash flows of the group for the year then ended, and have been properly drawn up in accordance with the provisions of the Companies Act 1965 and applicable approved accounting standards; and
>
> (b) the accounting and other records and the registers required by the Act to be kept by the company and by the subsidiary have been properly kept in accordance with the provisions of the Act.

We are satisfied that the accounts of the subsidiary that have been included in the group accounts are in form and content appropriate and proper for the purposes of the preparation of the consolidated accounts and we have received satisfactory information and explanations as required by us for these purposes.

The auditors' report on the accounts of the subsidiary did not include any comment made under sub-section (3) of Section 174 of the Companies Act 1965 except for the following qualification:

> As at 31 August 1998, the Company's current liabilities exceeded the current assets by RM2,368,499 and had accumulated losses of RM10,509 resulting in a capital deficiency of RM509.

The accounts have been prepared on a going concern basis assuming the continuing financial support from the holding company. Should the going concern basis on which the accounts have been prepared be not appropriate, adjustments would have to be made to reduce the value of assets to their realisable amounts and to provide for further liabilities which may arise.

An examination of the list of debtors of the company alone may not have revealed that unauthorised loans had been made by the company to its directors or to persons connected with them. However, given that the company had convened an EGM on 27 August 1999 to ratify the loans one would have expected that with due diligence such irregularities could have been easily detected by the auditors thereby obliging that they report the matter to the company shareholders. But the auditors may have their own reason for not disclosing or they may have perceived the irregularities in a different light. Whether or not their omission to do so tantamounts to negligence on their part is not within the scope of this Originating Summons. That question has to be decided on a substantive basis in another forum if required. But having failed to disclose the irregularities, seemingly in derogation of their duty, there could be no doubt that they now owe a moral duty to disclose the identity of the wrongdoer directors to the plaintiff.

The defendant had relied on the Singapore case of *Ikumene Singapore Pte Ltd v. Leong Chee Leng* [1993] 3 SLR 24 at 30, as authority that the duty if any that may be owed by the auditor is owed not to individual shareholders but to the general body of shareholders as a whole and that an individual shareholder such as the plaintiff in the instant case may not sue the auditor for any loss incurred consequent upon his reliance of the auditors' clean report of the company. The short answer to this submission is that the *Norwich Pharmacal* discovery being applied for by the plaintiff is not concerned with the auditor's legal duty in a cause of action for any tortious acts which the auditor may have committed, but merely with his moral duty to provide the

plaintiff with the identity of the wrongdoer to enable the plaintiff to institute a derivative cause of action in the name of the company against errant directors. Provided that his case comes within the four corners of the principle in *Norwich Pharmacal*, (an issue which I shall revert to shortly) he would be entitled to the order.

Are The Identities Of The Wrongdoers Already Known?

It was the submission of counsel for the defendant Mr. Sivasankar that no order of discovery can be made against the defendant as the wrongdoers who made the loans were the directors and their identities were already known to the plaintiff

Norwich Pharmacal was decided some 27 years ago. Since then the principle of discovery enunciated therein has been extended by the courts in the United Kingdom beyond its original action of merely facilitating the identity of wrongdoers.

Thus in *Bankers Trust Co v. Shapira* [1980] 3 All ER 353, discovery was ordered against a London bank requiring the bank to disclose to the plaintiff, such correspondences, cheques and banking records of two frausters kept in the said bank although their identity had already been known to the plaintiff.

In *CHC Software Ltd v. Hopkins and Wood* [1993] Fleet Street Report 24 in an action in slander of title, malicious falsehood and trade libel, documents relevant to the issues pleaded in the action that is to say, copies of letters and distribution lists of names in the hands of the defendant solicitors were required by the plaintiff. The court in holding that the jurisdiction to order such discovery was not limited to cases of identifying wrongdoers, ordered discovery against the defendant solicitors compelling them to disclose names and addresses of persons to whom threat letters had been sent together with the text thereof although the solicitors were clearly not wrongdoers.

In our jurisdiction however, the principle in *Norwich Pharmacal* has to be applied only in its pure form within the defined perimeter of *First Malaysia Finance*. A close scrutiny of the decision in *First Malaysia Finance* discloses that the Supreme Court had considered at length the extent to which the principle in *Norwich Pharmacal* is to be applied here in our jurisdiction probably as a matter of policy. Having referred to *Bankers Trust (supra)* among others to justify its acceptance of the principle in *Norwich Pharmacal*, the Supreme Court had nevertheless chosen to restrict the principle to merely a discovery of the identity of the wrongdoers as opposed to discovery of documents in the hands of another person which may implicate an already

known wrongdoer (the situation in *Bankers Trust Co.*). This is clear from the following passage of the judgment of Edgar Joseph SCJ, *supra*:

> Unlike the *Pharmacal* case, the present case was one where the identity of those who were alleged by the plaintiff to have committed the wrongful acts *vis-a-vis* the plaintiff were known to the plaintiff and, indeed they had been cited as the first to the fourth defendants in the action. So, on this ground alone there was no question of the fifth defendant, being such a 'person' within the meaning of the exception.

I would therefore have to agree entirely with counsel's submission that *Norwich Pharmacal* would have to be confined to the narrow ratio stated therein. The decision in *First Malaysia Finance* is unequivocal – where the identity of the wrongdoers had already been known, an order of discovery is unavailable.

Having defined the ratio it would now be necessary to return to the present summons to ask the question: Are not the identities of the wrongdoers already known to the plaintiff?

Invariably only the directors acting collectively could have approved the loans. Their identities therefore are already known. But this is only in so far as they relate to their collective wrongdoing in approving the loans. They may not necessarily be the wrongdoers who were receivers of the loans – persons from whom the plaintiff intends to sue to recover the loans on behalf of the company, whose identities may only be disclosed by the process of discovery which the plaintiff is now seeking from the defendant.

Can The Plaintiff Recover The Loans On Behalf Of The Company From The Wrongdoers?

An order of discovery may not be granted to the plaintiff unless he is able in law to institute a proceeding against the wrongdoer and has every intention to do so (*Handmade v. Express Newspapers* [1986] FSR 463. Similarly it would not be granted if it is not *bona fide* required to facilitate an action against the wrongdoer, but merely for a collateral purpose (*The Distillers Co. (Biochemicals) Ltd v. Times Newspapers Ltd* [1975] QB 613).

The plaintiff in the instant case intends to institute a derivative action on behalf of the company against the errant director or directors in order to recover from them such monies that may have been diverted to their use. That brings us to the next submission of the defendant's counsel that the right of action of the plaintiff lies with the company and not with the plaintiff as the alleged wrong was done to the company and therefore only the company has the right to bring an action – a contention based no doubt on the well known principle in *Foss v. Harbottle* 1843 Hare 461.

But there are exceptions to the rule in *Foss v. Harbottle*. (See the Court of Appeal case of *Abdul Rahim Aki @ Mohd Haki v. Krubong Industrial Park (Melaka) Sdn Bhd & Ors* [1995] 4 CLJ 551 which relied on the earlier judgment of Edgar Joseph J in *Tan Guan Eng v. Ng Kweng Hee* [1992] 1 MLJ 487 at 502 wherein five exceptions to the rule in *Foss v. Harbottle* were recognized.)

The rule does not apply if 'a fraud on the minority' (used here in its widest sense to include fraud arising from abuse of power) has been committed as such that no minority can ever hope to bring an action to enforce the company's right as the wrongdoers are in control of the company and would not bring themselves to institute such an action. In such a case a minority member may be allowed not as a matter of right but merely by the grace of the court to bring an action to enforce the company's right by a derivative action in the name of the company. The procedure is explained by Lord Davey in *Burland v. Earle* [1902] AC 83 at 93:

> It is clear law that in order to redress a wrong done to the company or to recover monies or damages alleged to be due to the company, the action should *prima facie* be brought by the company itself ... But an exception is made ... where the relief against whom relief is sought themselves hold and control the majority of the shares in the company, and will not permit the action to be brought against the company. In that case the courts allow the shareholders complaining to bring an action in their names. This, however, is a matter of procedure in order to give a remedy for a wrong which would otherwise escape redress ...

But a prospective plaintiff applying for the relief under the *Norwich Pharmacal* principle needs only to demonstrate that he has a viable cause of action against the wrongdoer and that the discovery is required in order that he may know for certain whether he has such a cause of action (See *P v. T* [1997] 4 All ER 200).

Norwich Pharmacal is after all a pre-action discovery as opposed to pre-trial discovery which a litigating party obtains under O. 24 of High Court Rules. Provided the prospective plaintiff can show he has a viable case against the wrongdoer and requires the discovery to facilitate his action, the court need not have to determine at this stage whether he would succeed in his action against the wrongdoers.

The Order

The plaintiff in my view is amply justified to apply for a *Norwich Pharmacal* discovery against the defendant.

The submission that the order should not be made because the plaintiff had not availed himself of the opportunity to seek clarification from the board of directors with respect to the nature of the loan before making the present application is without merit as the matter has been rendered *ex-post facto* by the fact that the loans to the directors had been ratified at the EGM on 27 August 1999.

The plaintiff is entitled to rely on the resolution as a fact that indeed loans had been made to certain companies which the directors may have interests in and whom the management was not prepared to disclose in full.

The defendant's contention that it is no longer in possession of the accounts and other accounting records of the company as the same had been returned to master concept is unacceptable. The plaintiff is not seeking from the defendant the actual accounting records of master concept. Understandably these may have been returned to the company after the defendant completed its auditing of the company's account. The plaintiff is seeking from the defendant the working papers upon which the defendant had based its audit report upon and any copies of the accounts that they may have from which such reports were produced which they may still have in their possession.

In due fairness to the defendant there shall be no order in terms of the prayer. Instead, there shall be an order that the defendant disclose on affidavit in the following 2 lists:

List A – copies of working papers, with copies of the accompanying files to the audit accounts and all documentation, if any, which it used and which the defendant now has in his possession, custody or power and which it is prepared to show to his opponent;

List B – copies of documents relating to the above which he had used but no longer has in his custody, possession or power, detailing what has become of them;

A party who obtains discovery from an involved party under O. 24 of the RHC is obliged to use the documents disclosed to him only for the proper purposes of conducting his own case, and there is an implied undertaking by him not to use them for any collateral or ulterior purpose (see *The Supreme Court Practice* [1995] Vol. 1 432 citing the case of *Distillers Co (Biochemicals) Ltd v. Times Newspaper Ltd* [1975] QB 613). A *fortiori* where an order of discovery is made against an uninvolved party such as the defendant in the instant case. There shall accordingly be a further order that before he obtains discovery of the documents the plaintiff shall give an undertaking to the defendant to restrict their use only for the specific purpose of initiating a derivative action against the wrongdoers to recover such monies as are due to the company.

Costs

As the defendant is entirely blameless in so far as the alleged tortious act of the wrongdoers is concerned, the plaintiff has to bear the defendant's expenses to provide the plaintiff with the information that he requires. (*Handmade v. Express Newspapers* [1986] FSR 463).

For the same reason, the plaintiff must also pay for the costs of the present proceedings. He will be at liberty to recover such costs as damages if he succeeds in his action against the wrongdoers (*Mortom-Norwich Products Inc v. Intercon No. 2* [1981] FSR 337).